Nos. 78-1474, 78-1480 and 78-1483

In the Supreme Court of the United States

OCTOBER TERM, 1978

DOUGLAS P. FIELDS AND ALAN E. SANDBERG, PETITIONERS

v.

UNITED STATES OF AMERICA

PETER S. DAVIS, PETITIONER

v.

UNITED STATES OF AMERICA

FREDERICK M. FRIEDMAN, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 79a-105a) is reported at 592 F. 2d 638. The opinions of

the district court (Pet. App. 1a-74a, 75a-78a) are not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 106a-107a) was entered on September 14, 1978. A petition for rehearing was denied on February 14, 1979. On March 8, 1979, Mr. Justice Marshall extended the time within which to file a petition for a writ of certiorari to and including March 26, 1979. The petitions in Nos. 78-1474 and 78-1480 were filed on March 26, 1979. The petition in No. 78-1483 was filed on March 27, 1979, and is therefore one day out of time. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether an indictment charging that petitioners received substantial undisclosed kickbacks while serving as officers and directors of two publicly-held corporations adequately alleges that they failed to disclose material facts in violation of the federal securities laws.

2. Whether the indictment should have been dismissed because the Securities and Exchange Commission failed to reveal, at the time that it consummated a settlement of a civil proceeding brought against petitioners, that it had recommended an investigation and criminal prosecution of petitioners.

STATEMENT

1. In November 1976, a grand jury of the United States District Court for the Southern District of New York returned a 12-count indictment against petitioners and one co-defendant, alleging conspiracy to violate the securities laws, in violation of 18 U.S.C. 371, fraud

in the sale of securities, in violation of 15 U.S.C. 77q(a), fraud in the solicitation of proxies, in violation of 15 U.S.C. 78n(a), fraud in filing a registration statement and prospectus with the Securities and Exchange Commission, in violation of 18 U.S.C. 1001, and mail and wire fraud, in violation of 18 U.S.C. 1341 and 1343 (Pet. App. 81a-82a).

The fraudulent transactions alleged in the complaint involved two publicly traded corporations, TDA Industries, Inc. (TDA), and its subsidiary, Westcalind Corp. (Westcalind). Petitioners served as officers and directors of the two corporations.[1] The basis for the charges in the indictment were the following transactions, occurring between March 1971 and March 1973:

(a) In March 1971, petitioners Fields and Friedman caused Westcalind to pay $50,000 to a third party for services that were not performed. Of that sum, $35,000 was repaid to petitioners Fields and Friedman for their personal use (Pet. App. 4a-5a). These transactions were referred to as the "Westcalind kickback" in the lower courts (Pet. App. 4a-5a).

(b) In April and May 1971, petitioners Fields, Friedman and Davis purchased (through a nominee) several thousand shares of unregistered TDA stock from an investment company (ERD) and from certain other investors at a price substantially below market price. They falsely represented to the sellers that the

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[1]Petitioner Fields served as president and chairman of the board of directors of TDA and Westcalind. Petitioner Friedman served as vice-president, secretary and treasurer of TDA, as well as treasurer and director of Westcalind. Petitioner Sandberg served as vice-president and director of TDA, as well as director of Westcalind. Petitioner Davis was TDA's attorney and also served as a Westcalind director (Pet. App. 8a).

stock could only be disposed of at a discount in a private placement transaction. By prearrangement, however, those shares were immediately registered by petitioners and resold to the public at a substantial profit, 70% of which was recovered by petitioners. This transaction was referred to as the "ERD kickback" in the lower courts (Pet. App. 5a).

(c) In November 1971, petitioner Fields paid various persons to purchase substantial quantities of TDA stock on the open market prior to a public offering of TDA stock. The purpose of those purchases was to cause the market price of TDA stock to rise to an artificially high and inflated level (Pet. App. 4a).

(d) In February and March 1973, petitioners Friedman and Sandberg caused TDA to pay a third party $100,000 for services that were not performed. The third party then refunded $82,000 to petitioners Friedman and Sandberg. This was described as the "Eagle Roofing kickback" in the lower courts (Pet. App. 6a).

Based on these transactions, counts 1 and 2 of the indictment charged that petitioners Fields, Friedman and Davis conspired to, and did in fact, commit fraud in the November 1971 sale of TDA stock. That fraud resulted from their market manipulation activities and from their failure to disclose the ERD and Westcalind kickbacks in offering prospectuses disseminated to public investors. Counts 3, 4 and 5 charged that petitioners Fields, Friedman and Davis filed a false registration statement with the SEC regarding the TDA stock offering. Those counts also charged that petitioners Fields, Friedman and Davis distributed false proxy solicitations to TDA stockholders in December 1971 that failed to disclose the market manipulation

scheme and the ERD and Westcalind kickbacks. Counts 6 through 11 of the indictment charged petitioners Friedman and Sandberg with wire and mail fraud violations that occurred during the course of the Eagle Roofing kickback (Pet. App. 81a-83a).

2. Petitioners moved to dismiss the indictment based upon alleged governmental misconduct. In response, the district court conducted a hearing and made findings of fact regarding the events preceding the return of the indictment. The evidence showed that in 1974 the District Attorney of New York County commenced an investigation of petitioners' activities. In January 1975, he concluded that petitioners' conduct was not properly the subject of state law enforcement but rather was a matter for investigation by federal authorities. Recognizing that the District Attorney was planning to refer the case to the Securities and Exchange Commission, petitioners decided to disclose some of their illegal activities to the SEC in the hope that they could negotiate a favorable settlement and avert a federal criminal prosecution (Pet. App. 9a).

In September 1975, the SEC filed a civil complaint against petitioners seeking, *inter alia,* disgorgement of funds fraudulently obtained from TDA stockholders, the appointment of a receiver, and an injunction to bar petitioners Fields and Friedman from serving as officers or directors of TDA (Pet. App. 16a, 22a-23a). Both before and after the filing of the civil complaint, petitioners' attorneys met with the SEC attorneys and stated their assumption that the SEC would not recommend a criminal prosecution. The SEC attorneys did not correct this misimpression. In addition, the district court found that an SEC attorney stated to a third party that there would be no criminal reference

after the civil suit was settled. That statement was later repeated by the third party to petitioner Fields (Pet. App. 18a-19a).

On December 1, 1975, the SEC attorneys sent pleadings that had been publicly filed in the SEC's civil proceeding to the United States Attorney (Pet. App. 20a). They did not disclose that fact during continued negotiations with petitioners. Shortly thereafter, petitioners agreed to settle the civil action by submitting to an injunction and other ancillary relief (*id.* at 21a-24a). The United States Attorney subsequently investigated the TDA case, presented the matter to a grand jury, and obtained an indictment on November 8, 1976 (*id.* at 89a).

3. Based on an exercise of its "supervisory powers," the district court dismissed substantial portions of the indictment. Although the court rejected the contention that the SEC had expressly promised petitioners not to refer their case to the United States Attorney (Pet. App. 27a-28a), it nonetheless concluded that the SEC attorneys, in light of all the circumstances, had misrepresented their intention with respect to a criminal referral (*id.* at 36a).[2] As an alternative ground for decision, the district court held that substantial portions of counts 1, 2 and 3 of the indictment were

[2]The government did not challenge on appeal the factual findings of the district court. Accordingly, we do not address here whether the district court was correct in crediting the testimony of petitioners' counsel who, as the court of appeals noted, were well "aware of the SEC's long standing and well known policy *against* settling civil actions in a manner that would impair subsequent criminal prosecutions." Pet. App. 86a-87a (emphasis in original). The court of appeals also noted that many of the district court's findings "hinged on close questions of credibility." Pet. App. 85a n.5.

deficient because the ERD kickback was not, as a matter of law, "material" to investors who purchased TDA stock in November 1971. Similarly, the court held that count 4 of the indictment was deficient because the ERD and Westcalind kickbacks were not, as a matter of law, "material" to TDA stockholders who received proxy solicitations in December 1971 (Pet. App. 46a-57a, 74a).

The court of appeals reversed, holding that the district court abused its discretion in dismissing the indictment. Although it too was critical of the SEC attorneys, the court of appeals held that under all the circumstances the extreme sanction of dismissal was not necessary to avoid "prejudice to the defendants in this criminal prosecution" or to deter widespread official misconduct (Pet. App. 98a). The court also noted that the "materiality" of the self-dealing transactions concealed by petitioners presented a mixed question of law and fact, rather than a pure question of law susceptible to disposition on a motion to dismiss (*id.* at 99a-104a).

ARGUMENT

1. Even if petitioners' claims would otherwise merit review, this Court should not now consider their challenges to the court of appeals' reinstatement of the indictment. The ruling below places petitioners in precisely the same procedural position they would have occupied if the district court had denied their motions to dismiss. Such an interlocutory order would not have been subject to pretrial appeal. See *United States* v. *MacDonald,* 435 U.S. 850, 853-863 (1978); *Cogen* v. *United States,* 278 U.S. 221, 222, 224 (1929). The same considerations that counsel against interlocutory appeals of denials of motions to dismiss weigh against

interlocutory review by this Court of the issues now presented by petitioners. Petitioners were indicted over two years ago and have not yet been tried. At trial, petitioners may be acquitted, in which event their claims will be moot. If, on the other hand, petitioners are convicted and their convictions are affirmed, they will be able to present all of their contentions to this Court when seeking review of the final judgment. See generally *Brotherhood of Locomotive Firemen & Enginemen* v. *Bangor & Aroostook Railroad Co.*, 389 U.S. 327, 328 (1967).

2. In any event, the decision of the court of appeals is correct and does not warrant further review.

Petitioners contend (Fields Pet. 13-18; Friedman Pet. 31-36) that the court of appeals erred in reinstating counts 1-4 of the indictment because those counts merely allege concealment of immaterial information. However, the indictment expressly charges that the undisclosed information was "material" (Pet. App. 100a). And as this Court held in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 450 (1976), determinations of "materiality" require "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact." The Court's admonitions in *Northway* against resolving disputed issues of materiality on motions for summary judgment apply with even greater force to motions to dismiss.

a. Counts 1-3 of the indictment charge that petitioners failed to disclose various material facts in the offering prospectus disseminated to public investors in November 1971. Among the material facts alleged to have been concealed were the ERD kickbacks of April

and May 1971. The government is prepared to present evidence showing that these kickbacks defrauded TDA shareholders of $435,000 and served to personally enrich the company's President, Vice-President, and corporate counsel. Nothing could have been more material to potential TDA investors than to know that, only five months earlier, other investors in TDA had been cheated out of $435,000 by the company's two highest officers and attorney. A reasonable investor surely would have found that disclosure of this self-dealing scheme "significantly altered the 'total mix' of information made available." *TSC Industries, Inc.* v. *Northway, Inc.*, *supra*, 426 U.S. at 449.[3] Moreover, potential investors certainly would have wanted to consider the future adverse consequences to the corporation of petitioners' misdeeds. As the SEC's civil complaint demonstrated, intentional securities fraud by management may result in corporate receivership. Private litigation brought against the company as a result of such fraud may also result in substantial expense and exposure to large civil liabilities. In sum, the government was entitled to present evidence to the jury to prove that the ERD kickback scheme was a material fact requiring disclosure to the investing public.

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[3]Improper activities bearing on the integrity of a company's management have been held to be material under the *Northway* test. See, *e.g.*, *SEC* v. *Jos. Schlitz Brewing Co.*, 452 F. Supp. 824, 829-830 (E.D. Wis. 1978). Cf. *SEC* v. *Kalvex Inc.*, 425 F. Supp. 310, 315 (S.D. N.Y. 1975); *Cooke* v. *Teleprompter Corp.*, 334 F. Supp. 467 (S.D. N.Y. 1971). Besides showing the corruption of the management of the company soliciting additional funds, this information would show potential investors that management was deeply indebted to the company for "short swing" profits (see Pet. App. 102a). The ERD kickback scheme involved purchases and sales of large quantities of stock by

b. Count 4 of the indictment charges that petitioners Fields, Friedman and Davis violated Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a), and Rule 14a-9 thereunder, 17 C.F.R. 240.14a-9, as a result of their dissemination to TDA stockholders of misleading proxy solicitations in December 1971. The matter for which proxies were solicited was the election of corporate directors, including petitioner Friedman. Count 4 charges that the proxy solicitations omitted to state material facts pertaining to the qualifications of petitioner Friedman for the position of corporate director, including his participation along with the other defendants in the March 1971 Westcalind kickback and the April and May 1971 ERD kickback.

Petitioner Friedman's involvement in fraudulent self-dealing transactions that had the effect of cheating TDA stockholders and of depleting the assets of a TDA subsidiary (Westcalind) was directly relevant to his qualification to serve as a director. Contrary to petitioners' contentions (Friedman Pet. 36-40), it certainly cannot be said that, as a matter of law, a reasonable shareholder would have viewed as insignificant the fact that petitioner Friedman and his co-defendants had cheated TDA stockholders (the ERD group) of $435,000 and caused one of the company's subsidiaries to pay an improper $50,000 "finder's fee" in order to personally enrich themselves (Pet. App. 4a-6a, 82a-83a). Indeed, it is unlikely that

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statutory insiders within a few days of each other. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), petitioners could be required to disgorge the profits made on these transactions. See generally *Foremost McKesson, Inc.* v. *Provident Securities Co.*, 423 U.S. 232, 243-244, 251 (1976).

any reasonable shareholder would have voted for petitioner Friedman if this information had been disclosed. Such information, bearing directly on the honesty of the director to be elected, is of fundamental relevance to the election process.

Moreover, Item 7(f) of Schedule 14A, 17 C.F.R. 240.14a-101(f), specifically required petitioners to disclose "any transactions * * * to which the issuer or any of its subsidiaries was * * * a party, in which any of the following persons had or is to have a direct or indirect material interest. * * * (1) Any director or officer of the issuer; (2) Any nominee for election as a director * * *." Petitioners' involvement in the Westcalind kickback transaction plainly had to be disclosed under this standard (see Pet. App. 103a). Finally, Item 7(e)(4) of Schedule 14A, 17 C.F.R. 240.14a-101(e)(4), expressly requires the proxy solicitation to disclose the "indebted[ness] to the issuer * * * [of each] director or officer of the issuer * * * [including] any indebtedness * * * [that] arose under Section 16(b) of the Act * * *." Because petitioners' sale of TDA stock immediately after acquiring it during the ERD kickback scheme (see note 5, *supra*) would give rise to liability under Section 16(b) of the Securities Exchange Act (Pet. App. 103a), petitioners' failure to disclose the liability violated the proxy rules.[4]

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[4]In a criminal prosecution such as this, the government is only required to prove a willful violation under Section 14(a) and the SEC rules promulgated thereunder. See Section 32 of the Act, 15 U.S.C. 78ff. Questions of "causation," while relevant in civil damage actions, are not relevant in a criminal proceeding. Civil cases of the kind relied on by petitioners (Friedman Pet. 36-38), which have considered the question whether securities law violations caused compensable injury to the plaintiff, are not pertinent here.

2. Petitioners contend (Fields Pet. 19-22; Friedman Pet. 21-30) that the indictment should have been dismissed because SEC employees did not follow required procedures when recommending investigatory action by the United States Attorney.

Both courts below correctly rejected this claim (Pet. App. 32a-33a, 90a-95a). As the lower courts noted, the relevant statutes (15 U.S.C. 77t(b) and 78u(e)) simply provide that the SEC may transmit evidence of securities law violations to the Attorney General, who, in his discretion, may seek an indictment. The statutes do not suggest that it is improper for members of the Commission's staff to communicate formally or informally with the United States Attorney, and the Commission's regulations encourage such cooperation (see Pet. App. 92a-94a). Moreover, even if the SEC failed to follow its normal procedures in transmitting information to the United States Attorney, that alone would not require suppression of the information or dismissal of the indictment. See generally *United States* v. *Caceres*, No. 76-1309 (Apr. 2, 1979).

In any event, the United States Attorney's authority and duty to prosecute violations of the law are not dependent upon a delegation by the SEC. The Attorney General, acting through the United States Attorney, is empowered to enforce all federal criminal statutes, including the securities laws. The statutory provisions relied on by petitioners clearly state that the decision to prosecute is a matter of discretion vested in the federal executive, not the SEC. Hence, an improper reference would not affect the validity of the indictment.

3. Finally, petitioners contend (Fields Pet. 22-25; Friedman Pet. 7-21) that the indictment should have

been dismissed because SEC attorneys failed to disclose that they had urged the United States Attorney to conduct a criminal investigation before concluding a settlement with petitioners in the civil injunctive proceeding. We agree with the district court and the court of appeals that this conduct by certain members of the Commission's staff was improper.[5] But, as the court of appeals pointed out (Pet. App. 97a-98a), petitioners suffered no prejudice whatsoever in the criminal action as a result of the SEC's behavior, and therefore "[t]he relief granted [by the district court] was wholly out of proportion to the wrong sought to be corrected" (*id.* at 96a). Throughout the civil investigation, petitioners relied on their privilege against self-incrimination, and the government gained no incriminating evidence from them that could be used at trial. See *United States* v. *Parrott*, 425 F. 2d 972, 976 (2d Cir.), cert. denied, 400 U.S. 824 (1970). Because petitioners received no unfulfilled promises and made no self-incriminating statements, this case is quite different from *United States* v. *Rodman*, 519 F. 2d 1058, 1059 (1st Cir. 1975), where "the Securities and Exchange Commission had obtained substantial information, including self-incriminating statements from the appellee on the basis of a promise * * * [that] was never fulfilled."[6]

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[5]Both of the SEC lawyers directly involved in the negotiations with petitioners' counsel have since resigned their positions with the government.

[6]There is thus no conflict between the decision of the court of appeals in this case and the decision in *Rodman*. We also note that the court of appeals did not hold, as petitioners contend, that the district court's supervisory jurisdiction could never empower it to dismiss an indictment; rather, the court held that, under the facts of this case, such an extreme sanction was unwarranted and an abuse of discretion (see Pet. App. 98a).

There is no suggestion in the record that petitioners ever received a promise of immunity from prosecution. Rather, the district court's theory was that the SEC attorneys were bound, as a matter of fairness, to disclose their communication with the United States Attorney and their intention to make a criminal reference, so that petitioners would not be misled into settling the civil action on the basis of a misunderstanding. Even on that assumption, however, the misconduct involved here could only have affected the civil settlement, because it may have led petitioners to enter into the settlement in ignorance of an event relevant to their expected *quid pro quo*.[7] There was nothing objectionable about the criminal prosecution itself: as noted above, no promise had been given that the case would not be prosecuted, and the United States Attorney had an independent duty to enforce the statute.[8] Thus, regardless of the sources of the prosecutor's information and the conduct of the persons who transmitted it, the valid indictment, returned by a legally constituted grand jury, "is enough to call for trial of the charge on the merits." *Costello* v. *United States*, 350 U.S. 359, 363 (1956). See *United States* v. *Calandra*, 414 U.S. 338, 349-352 (1974). The court of appeals properly concluded that the district court's "supervisory" authority did not, in the circumstances presented here, empower it to

[7]The court of appeals did not foreclose the possibility that the civil settlement might be modified, if appropriate, to remedy any actual prejudice resulting from the SEC misconduct (Pet. App. 96a n.21).

[8]The district court specifically noted: "I find no fault with the actions of any member of the office of the United States Attorney for this district" (Pet. App. 45a).

exercise "a 'chancellor's foot' veto over law enforcement practices of which it did not approve." *Hampton* v. *United States*, 425 U.S. 484, 490 (1976).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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